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SUBJECT: HOPES AND FEARS IN TURKEY' ELECTRICITY SECTOR

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11. (SBU) SUMMARY: With growing fears of an electricity supply deficit in Turkey by the end of the decade, the Turkish government has announced plans to add nuclear power to its energy mix and the private sector is calling for greater clarity on the investment framework. While the U.S. firm AES remains interested in the electricity distribution privatization, the government and judiciary continue to grapple with existing, politically-charged BOT and BO models that provide a significant portion of electricity, but are perceived as locked into high prices. Despite the controversy, the government is expected to continue to honor its contracts for purchase of electricity from BOT and other power plants. End Summary.

Electricity Shortfall Looms

12. (SBU) There is a growing recognition of an electricity shortfall in 2008-10, but the Turkish government has not come up with a serious action plan to grapple with this. Energy Ministry base case projections show a gap of 10,000 megawatts in 2009. While Turkey has announced its decision to add nuclear power to its energy mix, this will be over a longer time frame and difficult to achieve. Both the public and private sectors are frustrated that the 2001 Electricity Market Law and associated Electricity Strategy Paper have not resulted in more investment from the private sector in the electricity sector as time runs short to put in place new investment in production capacity to meet the imminent shortfall.

13. (SBU) At a recent energy conference in Istanbul, officials lamented that Turkey had not yet achieved an active energy market and officials were still grappling with assuring security of supply (like their counterparts in the EU). Public sector participants expressed frustration with meager investment results in the energy sector, pointing out

that the Electricity Market Law requires investment to come from the private sector. Private sector participants expressed frustration with slow progress on needed legislative and regulatory steps that would facilitate investment in the energy sector. Especially with respect to nuclear power, there was clamor for a greater role and commitment from the public sector.

14. (SBU) Electricity distribution (now carried out by state company TEDAS) was identified in the Electricity Strategy Paper as the first privatization step. Although this is now delayed by over one year, the U.S. firm AES has been persistent in its interest, but to date has been unable to review associated contracts and is concerned that key international arbitration clauses may not be present in the privatization documents (Ref C). Underlying legislation to facilitate privatization was long delayed, partly because some politicians sought to attach measures related to electricity exports to Iraq and controversial BOT power plants. A number of relevant amendments were adopted on May 10 intended to facilitate privatization of distribution, and generally not including the other issues. Once the legislation is in place, Privatization Administration officials express optimism for sequential tendering of twenty regional distribution entities.

15. (SBU) The intent of the 2001 Electricity Strategy Paper was to establish market transactions with the distribution company and then to embark on privatization of six mixed portfolios of production facilities (EUAS), but this too has been delayed. The Energy Market Regulatory Authority (EMRA) has been stymied in its efforts, partly because the state is still the main actor in the rudimentary electricity market. The GOT will remain the main owner-developer of large hydroelectric facilities, but the status of bilateral protocols for medium-sized hydro facilities, including one

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with the U.S., remains unclear. EMRA has been moving slowly on licensing small hydro facilities that take advantage of incentives under the Renewable Energy Law. Despite the GOT's intent to promote domestic resources for generation, a recent Council of State (Danistay) ruling stalled progress. The Danistay ruling found that EMRA was not empowered by law to hold tenders for granting generation licenses, preventing EMRA from selecting one of several companies when all were interested in one specific project. The ruling also had a negative effect on investors who already received a license and started construction, because the legal ground for their license has been put in question. The first significant wind based facility recently opened in Bandirma - with GE wind turbines.

Nuclear Quest

16. (SBU) The GOT has announced its intent to use a yet-to-be-defined public-private partnership model to put in place 5000 MW of nuclear power capacity, starting with a small pilot facility in Sinop Province on the Black Sea (Ref A). At the same energy conference, there was a lively debate of this decision. Many speakers applauded the decision to diversify Turkey's energy mix as necessary given high dependence on energy imports, in particular natural gas (from Russia and Iran), and supported the GOT's intent to use more indigenous resources (coal and hydroelectric). Other speakers questioned the timing and ability to finance these large investments, not to mention the need to safeguard and store nuclear waste. Environmental activists recently organized a 10,000-strong protest against the nuclear power plans in Sinop to mark the twenty-year anniversary of Chernobyl. (Note: We understand that GE and Westinghouse/Toshiba are interested in providing new nuclear technology to Turkey, but many interlocutors view the lack of progress from the U.S. on ratification of the Cooperation

on Peaceful Uses of Nuclear Power Agreement as an obstacle.
End Note.)

BOT Blues

¶7. (SBU) The portfolio of four BOT (Build-Operate-Transfer) plants which provide high-priced electricity (about 11% of Turkey's total generation capacity) has long been a politically-charged issue for GOT. It continues to appear that - despite a policy of calls for unilateral price reduction over the years and inspection and enforcement, which borders on harassment - the GOT will continue to honor its contracts (Ref D). Over the last year, the Energy Ministry has met individually with BOT owner-operators to apply pressure for price reductions. One local company, Colakoglu, reportedly agreed to a reduction (but as part of a diverse energy portfolio in Turkey). A Trakya (Enron/Prisma with USG EXIM exposure) rep told Econ Specialist that the company had made an offer in response to an earlier request from the Ministry for a tariff reduction. Although the GOT did not give a reaction or answer to date, the Trakya rep thought the Ministry remained unsatisfied by the company's offer. Trakya said that it was constrained in what it could offer - given lenders' needs and the fact that Trakya had only a single asset in Turkey. Another BOT facility with EXIM exposure, Doga Enerji, has felt comparable pressure from the MENR to unilaterally reduce prices.

Other Models also under Threat

¶8. (SBU) Surprise rulings from the Council of State (Danistay) over recent months (REF B) have put temporary "stay's" on a number of Build-Operate (BO) gas-fired plants, which are major providers of electricity in Turkey (Izmir and Adapazari). A number of these rulings have affected ENKA, which bought out U.S. Interger (although EXIM/OPIC exposure remains). An ENKA rep told Energy Officer that ENKA gained a temporary blocking measure from the Council of

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Ministers and noted that it held a Treasury guarantee for their payments. Many interlocutors scratch their heads at the contrarian Danistay ruling (finding that the facility agreements constitute a concession which requires Danistay approval), and conclude that it adds to uncertainty in Turkey's energy investment environment.

Comment

¶9. (SBU) Over the years the GOT has cancelled a number of BOT's and Transfer-of-Operating-Rights (TOR) contracts - some of which are in arbitration, adding to investment environment uncertainty. TOR is the practical model of choice for the electricity distribution privatization, as opposed to outright asset sale, which could face constitutional challenges in the courts. Adding to investor concern is a perception of late payments from the GOT for electricity and/or -last year- some reductions in off-take from BO facilities, even though this is guaranteed from the GOT as a take or pay obligation. Finally, a number of plants, primarily corporate "self producers" were subject to reductions during the cut-off of gas from Iran last winter. Among these corporates is the Turkish conglomerate Zorlu, to whom Exim has exposure. The Energy Ministry and EMRA are not viewed as strong institutions with strong leadership by our interlocutors and the courts add to uncertainty and antagonism in the energy environment. While the GOT seems likely to honor existing contracts, Turkey will continue to struggle with how to deal with a looming electricity

shortfall. A growing perception of electricity supply crisis could prompt the GOT to step in with new incentives, adding to the patchwork of old and new models in place in the sector.

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